



DEKILLION

Structured and Corporate Finance

SOUTH AFRICAN SECURITISATION REGULATORY DEVELOPMENTS

Authors: Eugene G van den Berg and Annelies Jacobs

The article highlights some of the key regulatory developments, to be introduced by The South African Reserve Bank (“SARB”), regarding securitisation, in comparison with International regulatory best practices and existing regulations.

SARB recently released new draft securitisation regulation (“new guidelines”) for public comment. The overall focus and objective of the proposed changes are:

- To mobilise increased use of securitisation;
- To level the securitisation playing field,
- Allowing banks (originating banks and participating banks) a greater degree of participation through specific role clarification;
- Introduce and expand credit enhancement and the use of liquidity facilities;
- As a world first, to create alignment between the recently proposed Bank of International Settlement’s (“BIS”) new draft capital accord, and securitisation developments; and
- Refine existing Commercial Paper Regulations, Notice 2172 of 14 December 1994 (“CP Regulations”) for the purpose of issuing and listing Asset-Backed Securities (ABS) pursuant to new guidelines.

These developments include similar regulatory developments introduced in some other international jurisdiction with specific reference to The United Kingdom (“UK”) and Australia.

UK SECURITISATION REGULATIONS

The UK securitisation regulations provide for, but not limited to, the following salient features:

Methods of transferring risk in recognition of “true-sale”

The method of transfer will have an impact on risks¹ as well as accounting treatment of the assets, and should therefore be properly assessed against the type of asset-

¹ FSA Prudential requirements and policies. The FSA regulates the financial services industry and has four objectives under the Financial Services and Markets Act 2000: maintaining market confidence; promoting public understanding of the financial system; the protection of consumers; and fighting financial crime.

class, the underlying agreements, and the proposed securitisation structure.

Novation: Existing agreements between the originator and the underlying borrower is cancelled and a new agreement between the investor and the underlying borrower is entered into. Novation is regarded as the cleanest form of transferring all rights and obligations from the originator to a Special Purpose Entity (SPE)

Assignment: Under assignment the rights but not the obligations are transferred from the originator to the SPE. Assignment that is duly notified by the originator to the borrower is stronger than silent assignment under which circumstances the consent of the borrower is not required to perfect the assignment by the SPE.

Sub-participation: Transfer through sub-participation allows transferred credit risk with exclusion thereof from the capital of the originator and with inclusion in the SPE as representing a part claim against the underlying borrower. It does not transfer the rights or obligations of the originator with the result that the SPE obtains recourse to the originator. The SPE obtains the economic benefits, however, not the legal entitlement.

Un-drawn commitments: Transfer of un-drawn commitments holds various degrees of risk for both the originator and the SPE. The originator is divested from obligation risk only when the transfer is executed through Novation or acknowledgement of assignment by an underlying borrower. A silent assignment and sub-participation only transfers the rights from the originator to the SPE.

Credit enhancement

The level of participation by an originator in a securitisation depends on the role being assumed by the credit enhancement provider. The roles are classified into primary and secondary roles. A primary role (relating to origination of securitisable assets) constitutes a bank as originator, sponsor, or repackager. An originator is the entity transferring assets from its balance sheet to an SPE for purposes of securitisation. A sponsor refers to a bank that repackages third party assets directly into a conduit² securitisation arrangement. As a repackager, the bank sells investment grade third party financial instruments via its balance

² A conduit is an SPE that facilitates separate transfer of assets from the same originator against separate issuances of ABS

sheet to an SPE that re-bundles them against the issuing of ABS.

A secondary role is assumed where the bank participates in a securitisation as servicer, credit enhancement provider, liquidity facility provider, underwriter and dealer, and the provider of bridging loans to an SPE.

Credit enhancement can be provided through a first-loss credit enhancement facility (“first-loss”) and/or a second-loss credit enhancement facility (“second-loss”) provided certain conditions for each are met. The main difference between a first-loss and a second-loss lies in the treatment thereof for capital adequacy. Since the first-loss facility absorbs the highest risk, the value thereof is treated as a capital impairment for capital adequacy purposes where such a facility is provided by the originator. The treatment of the second-loss is further subject to the degree of protection afforded by the first-loss. Where additional conditions relating to the degree of protection being afforded are not met, the second-loss is treated as a first-loss.

An originator providing a first-loss have a choice of treating the facility as a capital impairment or apply the normal risk weighting applicable on the assets had the securitisation not be executed. A second-loss provided by an originator is treated as a capital impairment for purposes of calculating capital adequacy.

First-loss being provided by a sponsor or repackager is treated as capital impairment for purposes of capital adequacy. Second-loss is weighted according to applicable banking regulation provided adequate disclosure is evident in the offering circulars.

Liquidity facilities

Liquidity facilities ensure timely fulfilment of obligations attached to ABS investors. It may only be utilised for accommodating timing differences. A fine line exists between credit enhancement and liquidity being provided. Credit risk may increase in the event of substantial default by the underlying borrower (“credit event” and/or a “trigger event”), thus increasing timing differences, which causes the liquidity facility to transform into a credit enhancement facility (the liquidity facility facilitates direct economic benefit). As a result of this fine line between liquidity facilities and credit enhancement facilities, a liquidity facility need to fulfil specific conditions.

An originator may not provide liquidity facilities since it is deemed to be funding which endangers the quality of transfer, thus not constituting a clean-break. Where a sponsor or repackager provides a liquidity facility, normal risk weightings on drawn and un-drawn portions of the facility applies pursuant to banking regulations.

Bridging loans

A bridging loan for purposes of facilitating the transfer of assets prior to the commencement of the issuing of ABS is permissible under UK regulations, provided that the sponsor has no senior status, the loan is for a maximum term of 3months, and the maturity of the assets must be substantially longer than the maturity of the bridging loan. Where these conditions are not fulfilled, the assets are treated as on-balance sheet of the sponsor or the repackager.

Underwriting and Dealing

Originators may underwrite the issuing of ABS provided that the transfer of the assets to the SPE is not recognized until at least 90% of the ABS has been issued to third party ABS investors. Subsequent to the fulfilment thereof, trading in ABS with investors is subject to the normal dealing limits of the originator and further limited to trading in ABS that are investment grade. Non-compliance result in the excess over pre-determined dealing limits to be treated as a capital impairment for purposes of capital adequacy. Trading in non-investment grade or un-rated ABS is treated as credit enhancement for purposes of capital adequacy in which instance the normal conditions pertaining to credit enhancement facilities apply to determine the attributable capital adequacy treatment.

AUSTRALIAN SECURITISATION REGULATIONS

Australian Prudential Standard for securitisation provides for, but not limited to, the following salient features for the conduct of securitisation.

Methods of transferring risk in recognition of “true-sale”

Prudential Standards³ require that unless the transfer of assets constitutes a clean-break, the assets will attract risk-weighted capital for purposes of capital adequacy.

Australian law recognises Novation and Acknowledged Assignment as representative of “true-sale”. Other issues affecting the status of clean-break include:

- The originator is not to retain any beneficial interest in assets transferred;
- All risks, obligations, and rewards are transferred to the SPE;
- The SPE has no formal recourse to the originator except for instances resulting from breach of warranties or representation,
- The originator is to receive a fixed amount for the assets transferred at the same time as the transfer takes effect,

³ Prudential Standard :-Funds Management and securitisation. Prudential Standards are maintained and regulated by The Australian Prudential Regulatory Authority

-Additional risks emanating from changes to the underlying agreement with the borrower must be absorbed by the SPE.

Credit enhancement

As in the case under UK regulation, credit enhancement facilities are subject to fulfilment of certain conditions. Australian regulations do not specifically define the various roles taken up by participants in securitisation for purposes of the treatment of credit enhancement facilities for calculating capital adequacy.

First-loss is treated as a capital impairment for purposes of capital adequacy. Second-loss is treated at a 100% conversion factor and taken at a 100% risk weighting for calculating capital adequacy. Where the originator provides, a first-loss and second-loss, the second-loss, amongst other conditions, is to be provided through subordinated ABS, which is to be readily transferable, by the originator. Where the additional conditions pertaining to a second-loss is not met, both the first-loss and second-loss is treated together as a first-loss for purposes of capital adequacy.

Liquidity facilities

The purpose of using liquidity facilities under Australian Prudential Standard is the same as in other international jurisdictions, to accommodate timing differences in cashflows being generated by underlying assets and the fulfilment of obligations to ABS investors.

Where a liquidity facility is provided in the absence of other credit enhancement facilities normally provided by independent third parties, the liquidity facility is regarded as a credit enhancement facility for purposes of capital adequacy except where the facility is capped at 10% of outstanding ABS on an unsecured basis or 20% on a secured basis. Where these conditions are met the liquidity facility is treated as commitment to provide finance for purposes of capital adequacy.

In addition to the aforesaid, where substantial credit enhancement is provided by a third party, and the bank's only commitment is the liquidity facility, such liquidity facility may be treated as a commitment to provide finance for purposes of capital adequacy.

During the establishment phase of a securitisation, the bank is allowed to provide the full liquidity requirement, provided that it can increase participation by third party liquidity providers within a maximum period of 3-months. In such instance where the liquidity facility does not exceed more than 10% of the banks capital, the liquidity facility is treated as a commitment to provide finance for capital adequacy purposes.

Lending

Lending facilities are permissible to facilitate the transfer of assets from the originator to the SPE to accommodate timing difference between the transfer of assets and the issuing of ABS. Such facilities may be treated as a commitment to provide finance for capital adequacy purposes provided, amongst other conditions, that:

- The facility has a known maturity;
- The facility is used to acquire assets; and
- Repayments attached to such a facility are not subordinated in any form.

Non-compliance with these requirements result in the treatment thereof as a credit enhancement facility.

Lending by a bank to investors for the purpose of acquiring ABS to be issued by the SPE is permissible under Australian Prudential Standard and will be recognized as commitment to provide finance for purposes of capital adequacy, provided, amongst other conditions, that:

- The arrangements fulfil the conditions noted above; and
- The bank has full recourse to the investor beyond the collateral supporting investment in ABS.

Non-compliance result in such lending facilities to be treated as credit enhancement facilities for calculating capital adequacy.

Underwriting and Dealing

The originator may act as underwriter of ABS up to 100% of the issue and/or acquire up to 100% of the issue of ABS; and treat such activities as underwriting facilities for calculating capital adequacy provided, amongst other conditions, that:

- The facility is limited to a certain amount and time period; and
- The facility is utilised only when an SPE cannot issue ABS in the market at a price equal to or greater than the benchmark-underwriting price specified in the underwriting agreement

Underwriting facilities for the purpose of underwriting subordinated ABS are treated as credit enhancement facilities for capital adequacy purposes.

A bank may only acquire ABS for its own account after the initial issue, once its initial holdings as a result of underwriting, has fallen below 20% of the initial issue of ABS. Where the threshold has not fallen to below 20% after 3-months since the issue commenced, the ABS must be mark-to-market for regulatory reporting.

Banks may further enter into sub-underwriting arrangements with third parties subject to the fulfilment of conditions in addition to those listed above.

SOUTH AFRICAN SECURITISATION REGULATIONS

The salient features of the **existing securitisation regulatory framework in South Africa** is contained in Securitisation Schedule (“Sec schedule”), Notice 153 of 3 January 1993 and Commercial Paper Schedule (“CP Schedule”), Notice 2172 of 14 December 1994 (with regards to the issuing of ABS)

Conditions retained in the new guidelines, from the existing regulations, in support of clean-break are:

- Transfer is to be executed pursuant to an agreement between the originator and the SPE;
- Transfer must totally divest the originator from all rights and obligations and all risks and rewards;
- Transfer must not result in a breach of the terms and conditions of the underlying transaction;
- SPE shall not have a right of recourse against the originator;
- Originator may replace any asset, excluding a non-performing asset, with an equivalent asset;
- SPE is subject to a change in the terms and conditions in the underlying transaction where such change takes effect subsequent to the transfer of the asset;
- Actual payments received by the originator in its capacity as servicer must be paid over to the SPE on actual receipt thereof (new guidelines is broadened to allow for transfer of payments prior to the actual payment received from the underlying borrower, where a primary role player also act as servicer, provided that it is treated as a separate short-term liquidity facility pursuant to the same conditions applicable to liquidity facilities);
- Subsequent transfers of additional assets are permissible only to maintain the original capital of the asset portfolio;
- The portfolio may consist of assets that are not homogeneous in nature, provided that the predetermined ratio must be maintained throughout the existence of the securitisation.
- The originator may not acquire shares or hold a beneficial interest in the SPE;
- The board or trustees of the SPE must be independent. (new guidelines expand this requirement to some degree allowing the originator to nominate one board member where the minimum directors or Trustees are 3);
- The name of the SPE must not be the same as that of the originator and/or include reference to the name of the originator. New guidelines reserve this limitation to banks only where a bank is the originator.

The assessment of **the new guidelines** against international regulatory frameworks, as sighted above, should also be viewed against the different methods of transfer evident in South African law in order to ascertain the practical effectiveness of additional conditions with regards to clean-break, servicing, credit

enhancement, underwriting, investment in ABS and providing of liquidity facilities.

Methods of transferring risk in recognition of “true-sale”

The new guidelines, as with the existing Sec Schedule acknowledges assignment as the prescribed transfer method, with the exception that other methods of transfer must be approved by SARB.

Novation: South African law also recognizes Novation. The implications are the same as under UK legislation.

Delegation: Under a delegation arrangement obligations excluding rights are transferred from one party to another.

Cession: Cession is the transfer of a right by agreement and differs from Novation. Under a Cession the consent for transferring rights not need to be consented to by an underlying borrower. It therefore affords the originator to transfer its existing and future rights enjoyed in an underlying agreement. The variants under Cession include a Cession by way of security through which the cedent retains a reversionary interest to receive back any surplus remaining after enforcement of ceded rights, such as ceding trade receivables as collateral for banking facilities. Absolute Cession divests the cedent (originator) from all rights and vests them with the Cessionary (SPE) to the extent that only the Cessionary is entitled to sue for the enforcement of rights. Cession by way of security is not supportive of clean-brake, “true-sale” and bankruptcy remoteness in securitisation.

Assignment: Through assignment both rights and obligations are transferred from one party to another. A securitisation with which assets are transferred by the originator to an SPE through assignment, effectively divests itself from all rights and obligations enjoyed in an underlying agreement with a borrower. The type of asset being securitised will influence the use of Assignment or Cession. Where both an Assignment or Novation is not the desirable method of transfer, the transfer would have to be perfected though an Absolute Cession, in which instance approval is required from SARB as it prescribes transfer of rights and obligations (Assignment).

Credit enhancement

Credit enhancement consists of a first-loss and/or a second-loss provided that certain conditions are met and subject to the role being assumed by the provider of such credit enhancement. This is very similar with regulations in the UK where the level of participation and type of credit enhancement being afforded is closely related with the role of the credit enhancement provider.

A primary role is defined as an originator, a remote originator, sponsor, or repackager. An originator is an entity that transfers assets from its balance sheet to an SPE provided that where it transfers assets amounting to less than 10% of the total assets transferred, the originator is regarded as a repackager or a sponsor. A repackager is an originator that transfers government security-, loan stock- (listed on The Bond Exchange of South Africa (“BESA”)) or any other loan stock (listed on a financial exchange) assets of third parties via its balance sheet to an SPE. A sponsor is an originator that facilitates the direct transfer of assets, other than its own assets, into an SPE. A remote originator is an entity that provides loan funding to an SPE for the purpose of granting credit (excluding customary credit) by such an SPE.

Secondary role players include participation by a bank as credit enhancement provider, liquidity facility provider, an underwriter, an investor in ABS, a servicing agent or a counter party in normal bank trading activities, also subject to certain conditions.

An originator (which includes an originator, remote originator, sponsor and repackager) may provide a first-loss and second-loss provided, in addition to other conditions, that:

- The first-loss is treated as an impairment against primary capital of a bank providing it for purposes of capital adequacy;
- The second-loss is treated as a credit substitute at a conversion factor of 100% with a risk weighting of 100% for capital adequacy purposes.
- The capital requirements on both, the first-loss and second-loss is limited to an amount that the bank would have had to hold for capital adequacy had the securitisation not been effected.; and
- Non-compliance with conditions attached to a first-loss and second-loss will result in such facility be treated as a first-loss for capital adequacy purposes.

Liquidity facilities

Liquidity facilities (excluding short-term liquidity facilities) may only be provided by a repackager or sponsor provided, amongst other conditions, that:

- The facility may be reduced or terminated as a result of a credit event;
- It limits conditions for utilization;
- It is not a permanent revolving facility;
- It is not subordinated in favour of ABS investors (Liquidity facilities may however be subordinated in favour of other liquidity facilities where the total liquidity facility requirement is tiered);
- Where the provider thereof also act as servicer, the standard treatment thereof within banking regulations apply; and
- Non-compliance will result in the facility be treated as a first-loss for purposes of capital adequacy.

Bridging loans

The granting of loans and bridging finance for the purpose of facilitating the transfer of assets before the issuing of ABS is executed (due to timing differences) is not specifically defined and described within the new guidelines compared with the manner provided for within UK and Australian regulations.

The circumstances in which bridging finance could be provided is dealt with under the meaning of remote originator and/or reference being made within new guidelines under liquidity facilities, where it is permissible for a primary role player (originator, remote originator, repackager and sponsor) to provide short-term liquidity facilities in the capacity as servicer. Such facilities too are subject to the same conditions as the conditions pertaining to liquidity facilities.

Underwriting and Dealing

Originators, remote originators, sponsors and repackagers all may cater for the underwriting of the issuing of ABS. The originator and remote originator must comply with the following conditions:

- Transfer of assets is recognized only once 90% of the ABS issuance is taken up by third parties; and
 - Securities held in excess of the 90% are treated as a second-loss for purposes of conformity with new guidelines and capital adequacy proposes.
- Sponsors and repackagers, at the end of the issuing concession period must comply with the following:
- Holdings of Senior ABS of which the rating is lower than BBB (or the equivalent thereof), or where no rating has been assigned, must be treated as a second-loss;
 - Holdings of ABS of which the rating is greater than BBB is regarded as a second-loss and must be treated according to the conditions supporting Investment in ABS (which conditions are discussed below).

Banks may enter into transactions included in the trading book of a bank provided that, amongst other conditions, the transaction do not involve the acquisition of ABS being issued by the SPE apart from such arrangements specifically provided for in the new guidelines and treatment for capital adequacy proposes include such transactions under trading activities pursuant to Banking Regulations. Non-compliance with such conditions will result in such trading transactions be treated as a second-loss for purposes of capital adequacy.

Investment in ABS

For purposes of investment by banks in senior ABS (including a bank as an investor or in a primary securitisation role), rated senior ABS will attract the following risk weightings for capital adequacy purposes:



- AAA - AA: 20% risk weighting
- A+ - A-: 50% risk weighting
- BBB+ - BBB-: 100% risk weighting
- BB+ - BB-: 150% risk weighting
- B+ or below: treated as a first-loss facility
- No rating: Senior ABS carries the same risk weighting of assets securitised. Where the portfolio comprises assets with different risk weightings, the highest risk weighting is applied on the Senior ABS.

These developments are in line with the recently proposed Capital Accord of BIS. Although these BIS requirements have not as yet being made mandatory, inclusion thereof, for purposes of securitisation in South Africa, can be seen as a world first. It paves the way for a higher degree of participation by banks in the development of securitisation viewed against the strong capitalization, on a risk weighted basis, of the South African banking sector. It should further promote the development of a secondary market, given a higher degree of bank participation.

Transfer of assets and re-purchase of assets

Sec Schedule has been broadened to include a framework through which a primary role player may re-purchase assets previously transferred to an SPE provided that:

- The repurchase is conducted on market related terms and conditions;
- The originator, remote originator, repackager and sponsor has no prior obligation to re-purchase assets;
- A Bank acting in a primary role may not hold more than 10% of the total assets transferred to an SPE;
- Re-purchasing of non-performing assets is certified by external auditors as to taking effect at market related conditions; and
- Where re-purchasing result in providing liquidity facilities, such conditions pertaining to liquidity facilities must be fulfilled in order to avoid the re-purchasing of assets to be treated as a first-loss.

The conditions sited above is to avoid absorbing risks in excess of first-loss and second-loss and/or causing a short-term liquidity facility to absorb disproportionate risks in relation to first-loss and second-loss and/or to facilitate and accommodate liquidity constraints during early amortisation as a result of a credit event and/or to avoid indirect asset substitution within securitisation of revolving assets⁴.

⁴ Bank of International Settlements; Basel Committee on Banking Supervision: Consultative document: - Asset Securitisation (special studies conducted on risks emanating from the complex nature of securitisation and risks normally associated with securitisation activities and developments attached to Conduits and revolving asset transactions)

Under UK regulations an originator acting as servicer may not provide separate short-term liquidity facilities to cover shortfalls on payments received from the underlying borrower with the exception that this condition is not applicable on a UK sponsor or UK repackager. Repurchasing is not permissible under UK regulations except in the instance where the repurchase is for breach of warranty or representation or the ABS has reduced to less than 10% of the face value of the assets, thus effectively avoiding the use of liquidity facilities to facilitate hidden risks sited in the preceding paragraph and to facilitate a soft bullet in an orderly fashion for winding down purposes and/or deferment of originally originated credit risk after the interests of ABS investors have been substantially safe guarded in early amortisation as a result of a credit event. Repurchasing by a sponsor or repackager is permissible provided the repurchase is effected at market prices (includes repurchasing of defaulted and investment grade assets with regards to financial instruments or performing and defaulted assets with regards to non-financial assets)

Repurchasing of assets by an originating bank or a third party bank, under Australian Prudential Standard, is permissible provided that:

- The repurchase is conducted at market prices;
- There is no prior obligation by the originator to enter into a repurchase with the SPE;
- The originator may not hold more than 10% of the total assets transferred to an SPE;
- The repurchase is completed within 6 months from time of committing to a repurchase;
- Non-compliance will result in the repurchase activity to be treated as a credit enhancement; and
- Where a repurchase supports ABS investors beyond any legal obligation, the total outstanding value of ABS is considered for purposes of capital adequacy.

Revolving assets

The transfer of additional assets, by an originator or remote originator within a securitisation involving revolving assets, is permissible provided that a credit conversion factor of 10% is applied and weighted at the risk weightings, for purposes of capital adequacy, had such assets not been securitised. SARB may, subject to additional conditions, approve a lower conversion factor.

In addition to conditions dealing with repurchasing and transfer under UK regulations, revolving assets create the sharing of risk and rewards between the ABS investors and the originator. Due to such sharing, securitisations are structured according to one of two approaches. Aggregated approach treats the assets as a homogeneous pool and payments received for a specified period is apportioned between ABS investors and the originator. The disaggregated approach allows

for each payment to be linked to specific receivables and each payment is allocated to either the originator or the ABS investors. Each approach qualifies for off-balance sheet treatment provided that conditions to ensure orderly operation is met.

Under Australian Prudential Standard the following conditions, in addition to orderly operation, are provided for:

- The discount rate for all transfers is fixed at the commencement of the securitisation;
- The originator does not provide additional assets once amortisation commences for purposes of maintaining a given cashflow or ratio coverage;
- Selection of portfolio is done randomly;
- Amortisation is scheduled for a fixed date in the future;
- The originator retains the right to cancel un-drawn facilities on commencement of amortisation of assets of which the utilization portion has already been transferred to the SPE; and
- The originator is under no obligation to repurchase defaulted assets; alter the amortisation period, except for early amortisation as a result of a credit event, and to alter the allocation of principal.

Issuing of ABS

CP regulations regulate the issuing of ABS as a result of the characteristics attached to ABS falling within the regulatory definition of Commercial Paper (“CP”) pursuant to CP Schedule. The CP schedule prescribe conditions, which if not complied with by the SPE, may result in the SPE contravening the Banks Act 94, 1990 (“Banks Act”) as a result of certain activities regarding the use of CP issuance proceeds falling within the meaning of the business of a bank pursuant to the Banks Act (although the activity of issuing CP is described within the CP Schedule as not falling within the meaning of the business of a bank). For this purpose, amongst other reasons too, the CP Schedule is broadened to include conditions specifically aligned with securitisation and for the purpose of providing practical compliance with new guidelines.

The salient features of newly incorporated CP regulations are summarised as follows:

- CP is to be issued in denominations of R1m or greater unless:
 - (i) it is listed on a recognized exchange;
 - (ii) endorsed by a bank;
 - (iii) issued for a period of longer than 5-years; or
 - (iv) explicitly backed by a Government Guarantee;
- The issuing of CP by a Juristic person is authorized by SARB; and
- Conformity with broadened disclosure requirements.

Whereas in the past the limiting factors included:

- Could only be issued by a listed company with a net asset value of R100m;
- Proceeds from the issuing of CP may not be utilised in granting loans directly or indirectly, except for customary credit relating to the sale of goods, unless the CP is issued by a bank registered pursuant to the Banks Act.

Summary

The new guidelines are a huge step forward and cater for a wider framework for credit enhancement, the use of liquidity facilities and higher participation by banks. The proposed changes better align the South African regulatory framework with that evident internationally with regards to the treatment of first-loss, second-loss and liquidity facilities.

The assignment of risk weightings, for investing in ABS, although this development can be seen as prematurely in comparison with proposed changes in the BIS Capital Accord, should substantially promote higher secondary market liquidity. As a result thereof, these developments should also contribute positively towards the faster development of a secondary corporate debt market as well as the listing and trading of debt instruments derived from underlying securitisation and corporate bond developments.

Certain aspects, as described below, may require further analysis and debate in order to ensure that the revised regulations do not create new limitations.

The regulatory meaning of transfer of assets will most likely create problems regarding the securitisation of revolving assets, future-flows and income streams as a result of assignment being recognised as the preferred method. Internationally other forms of transfer are regulatory recognised provided additional operational conditions are conformed to in clearly identifying derived risks that remain with an originator. South African law also recognises Cession, Delegation and Novation for purposes of transferring rights and obligations.

The introduction of various role players further establishes a better framework for the development of conduits and multi-seller conduits (although such developments have been undertaken in the past). However, the regulatory requirement regarding the transfer of additional assets limits that transfer to maintain original capital of the portfolio, which, places a limitation on the development of conduits and multi-seller conduits (although regulation reserves the right to allow additional asset transfers under circumstances other than maintaining capital with the prior approval of SARB).



Conduit and Multi-seller conduit arrangements are not limited to once-off and/or specific asset transfers. In view thereof, the regulatory definition assigned to repackager only permits the transfer of government securities and or debt securities that are listed (which is valid and applicable on the development of Collateralised Bond Obligations (CDO's) and similar arrangements). Internationally conduits and multi-seller conduits are not limited to take transfer of assets representing listed debt instruments only.

Bridging loans are not substantially defined in comparison with international regulations. New guidelines cater for bridging finance in a limited fashion through the role of servicing (short-term liquidity facilities that must conform to the same conditions being applied to liquidity facilities).

International regulations, herein noted, further make provision, against certain conditions, for the use of bridging finance in acquiring the assets to be securitised (allowing to bridge the time period between transfer of assets and issuing of ABS, which for successful property securitisation, as an example, is almost a given requirement). The regulatory definition assigned to "remote originator", suggests that the same in practice can be followed. This could result, measured against the regulatory treatment of liquidity facilities, in the use of bridging loans be treated as a liquidity facility that in essence represent a first-loss facility in which instance a bank providing such a bridging loan will be faced with an impairment against capital for capital adequacy purposes.

© Copyright 2001.

Publisher: Decillion Ltd, 26 Sturdee Avenue,
Rosebank2196,
Johannesburg,
South Africa

Author(s): As referred to on the first page. All rights reserved. When quoting, please cite Decillion Ltd and the author(s) as the source.

The information contained in this publication is derived from sources we believe are accurate and reasonable. Neither Decillion Ltd nor the author(s) guarantee its accuracy or completeness. Any opinions expressed reflect the current judgment of the author(s) and do not necessarily reflect the opinions of Decillion Ltd, or any existing or future subsidiary or affiliate of Decillion Ltd. The opinions reflected herein may change without notice. Neither the author(s), Decillion Ltd, nor any existing or future subsidiary or affiliate of Decillion Ltd accepts any liability, whatsoever, with respect to the use of this document or its contents. This report and/or article are for informational purposes only. Neither this document nor the contents thereof, nor any copy of it, may be altered in any way, transmitted to, or distributed to any other party. By reading, referring to, or using this document, you agree to be bound by all of the foregoing reservations.